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October 22, 1999



**By Hand**

Magalie Roman Salas
Secretary
Federal Communications Commission
Room CY-A257
445 Twelfth Street, S.W.
Washington, D.C. 20554

RE: Written Ex Parte Submission
In the Matter of Deployment of Wireline Services
Offering Advanced Telecommunications Capability
CC Docket No. 98-147

Dear Ms. Salas:

Transmitted herewith for inclusion in the public record of the above-referenced "permit but disclose" proceeding are two copies of a written *ex parte* letter that was delivered this day to Lawrence E. Strickling, Chief of the Common Carrier Bureau.

If you have any questions concerning this filing, please contact the undersigned.

Sincerely,

Charles W. Logan

cc: Carol Mattey
Jane Jackson
Howard Shelanski
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October 22, 1999

By Hand

Lawrence E. Strickling
Chief, Common Carrier Bureau
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, D.C. 20554



Re: Written *Ex Parte* Communication
In the Matter of Deployment of Wireline Services
Offering Advanced Telecommunications Capability
CC Docket No. 98-147

Dear Mr. Strickling:

This written *ex parte* is submitted in response to *ex parte* communications filed recently in the above-referenced proceeding by U S West, Inc. (U S West) and SBC Telecommunications, Inc. (SBC), on October 15, 1999 and October 8, 1999, respectively. This *ex parte* is submitted on behalf of NorthPoint Communications, Inc. (NorthPoint) and HarvardNet, Inc. (HarvardNet), which provide Digital Subscriber Line (DSL) services in markets across the country.

The U S West and SBC submissions represent the latest effort by incumbent local exchange carriers (LECs) to protect their residential markets from competition for DSL service. DSL competitive LECs have shown through their comments and written *ex parte* submissions in this docket that the Commission should: 1) require incumbent LECs promptly to offer access to line sharing as an unbundled network element for the provision of asymmetric DSL services by competitive LECs; 2) adopt specific pricing principles and guidelines for line sharing to assist state commissions in carrying out their responsibilities under section 252 of the Communications Act of 1934, as amended (Act); and 3) require incumbent LECs to offer line sharing on an interim basis, pending completion of the section 252 process, in order to facilitate the expeditious delivery of the benefits of DSL competition to residential consumers and to prevent incumbent LECs from continuing to exploit their position as the monopoly provider of DSL service to those consumers. So long as incumbent LECs remain the exclusive providers of DSL service over a shared line, DSL competitive LECs will remain at a severe competitive disadvantage in attempting to compete to serve residential customers.[1]

[1] Line sharing is not essential for DSL competitive LECs to serve business customers because those subscribers typically prefer to have DSL service provided over a different loop than the loop over which they receive voice service.

The U S West and SBC submissions raise technical/operational objections[2] as well as legal challenges to the proposals of the DSL competitive LECs. In this written *ex parte*, we address the legal arguments advanced by the incumbent LECs. The DSL competitive LECs have addressed other objections, especially those that are based on Operations Support Systems concerns, in separate *ex parte* submissions.[3] Although the U S West and SBC submissions do not directly challenge the proposals advanced by NorthPoint and HarvardNet in their October 8, 1999 written *ex parte* in this proceeding (October 8 Ex Parte), some may view the legal arguments as applicable to those proposals as well.

U S West and SBC generally contend that even if the Commission required incumbent LECs to offer line sharing as an unbundled network element to unaffiliated competitive LECs, the agency lacks authority to order incumbent LECs to provide line sharing on an interim basis, pending the amendment of their interconnection agreements with affected competitive LECs.[4] Moreover, U S West and SBC raise various challenges to pricing guidelines that DSL competitive LECs have urged the Commission to adopt in conjunction with a requirement that line sharing be offered as an unbundled network element.[5] In this *ex parte,* we show that these claims are meritless and should be rejected.

Both U S West and SBC emphasize that under the statutory scheme established by the Act, state commissions have the exclusive authority to establish the specific prices for access to unbundled network elements. We agree. Section 252 of the Act, 47 U.S.C. § 252, assigns to the state commissions the authority to set the prices for specific unbundled network elements if the parties are unable to reach agreement through the negotiation process. The Commission, however, has the overriding responsibility for administering the Act. As the Supreme Court observed when it recently upheld the FCC's jurisdiction to design a pricing methodology for UNEs, "[w]e think that the grant in § 201(b) means what it says: The Commission has rulemaking authority to carry out the 'provisions of this Act,' which include §§ 251 and 252, added by the Telecommunications Act of 1996."[6] Consistent with that responsibility, DSL competitive LECs have recommended specific guidelines that the Commission can and should adopt to furnish state commissions with a methodology that they can apply in setting specific prices for access to line sharing. For example NorthPoint and HarvardNet recommended in their October 8 Ex Parte that the Commission adopt a pricing principle that would require state commissions to ensure that the price of the loop component of

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2 U S West Letter at 4; SBCLetter at 3

3 *See* Letter to Magalie Roman Salas, Secretary from Dennis J. Austin, CC Docket No. 98-147 (October 19, 1999); Letter to Magalie Roman Salas, Secretary from Michael E. Olsen, CC Docket No. 98-147 (September 30, 1999).

4 U S West Letter at 1-2; SBC Letter at 1-2.

5 U S West Letter at 1-3; SBC Letter at 2.

6 *AT&T Corp. v. Iowa Uitils. Bd,* __ U.S. __, 119 S.Ct. 721, 730 (1999).

line sharing not exceed the loop cost that an incumbent allocates to its own DSL service provided over a shared line.[7] It perhaps bears emphasis that the two state commissions that commented on this issue in the rulemaking proceeding both urged the Commission to adopt pricing rules for line sharing.[8]

U S West and SBC do not appear to challenge the FCC's jurisdiction to establish such pricing guidelines for state commissions to apply if the parties are unable to reach agreement through the negotiation process. Rather, they claim that the FCC lacks authority to establish pricing principles that would apply to the incumbent LECs' provision of line sharing on an interim basis, as DSL competitive LECs have advocated.[9] Under the proposal advanced by NorthPoint and HarvardNet, for example, Commission-established pricing rules would be used by incumbent LECs to set interim prices for line sharing that would remain in effect until they are superseded by amended interconnection agreements, pursuant to the process set forth in section 252 of the Act, 47 U.S.C. § 252. As the Eighth Circuit has observed, "substantial deference by courts is accorded to an agency when the issue concerns interim relief."[10]

Contrary to the claims of U S West and SBC, the procedure recommended by NorthPoint and HarvardNet would require the rates for line sharing, even during the interim period, ultimately to be set through the section 252 negotiation and arbitration process. Specifically, in their October 8 *Ex Parte*, NorthPoint and HarvardNet suggested that the Commission establish principles for setting maximum interim rates for line sharing, consistent with the principles that state commissions would apply if the parties are unable to reach agreement through the negotiation process. NorthPoint and HarvardNet further suggested that the Commission could make these rates subject to a true-up at the conclusion of the section 252 process. That is, the incumbent LEC would be entitled to recoupment or the DSL competitive LEC would be entitled to a refund for rates paid during the interim period, based on the rate ultimately set either by the parties in negotiation or the state commission in an arbitration. This approach would both enable the prompt commencement of DSL competition to serve residential customers as well as ensure that the specific charges paid by DSL competitive LECs for line sharing would be established through the section 252 process. Indeed, U S West essentially concedes that such a true-up process protects incumbent LECs against the risk that an interim rate would amount to an unconstitutional taking.[11] Similarly, a true-up procedure would

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[7] *See* Written Ex Parte Communication of NorthPoint Communications, Inc. and HarvardNet, Inc., CC Dkt. No. 98-147, at 4 (October 8, 1999) (October 8 *Ex Parte*).

[8] *See* Comments of the State of California and the Public Utilities Commission of California, ccDkt. No. 98-147, at 8 (June 15, 1999); Comments of the Oklahoma Corporation Commission, CC Dkt. No. 98-147, at 19 (June 15, 1999).

[9] *See* U S West Letter at 2; SBC Letter at 2.

[10] *Competitive Telecommunications Ass'n v. FCC,* 117 F.3d 1068, 1073-74 (8th Cir. 1997), *affirming in part* Local Competition First Report and Order, 11 FCC Rcd 15499 (1996).

[11] *See* U S West Letter at 3.

protect DSL competitive LECs against the risk that the interim rates set by an incumbent LEC are too high. Further, the procedure outlined by NorthPoint and HarvardNet preserves the integrity of the section 252 process.

The October 8 *Ex Parte*, in addition, proposed "surrogate line sharing" as a temporary means of bringing residential DSL competition to markets where incumbent LECs allege that they are unable to provide line sharing to DSL competitive LECs on a timely basis. Under this approach, non-compliant incumbent LECs would be required to offer access to separate loops for DSL service at a very significant discount from the unbundled loop price until such time as the incumbent was able to offer line sharing to competitive LECs pursuant to FCC requirements. During this period, such incumbent LECs also would be prohibited from offering line sharing to new customers. The point of this approach is obviously not to create a new, permanent unbundled network element known as surrogate line sharing. Rather, as stated in the October 8 submission, the objective is to ameliorate the current anticompetitive conditions in the residential DSL market until an incumbent LEC is able to offer access to line sharing to competitive LECs. Surrogate line sharing would eliminate the incumbent LEC's ability and incentive to be the exclusive provider of DSL over a shared line, because it would require both incumbent and competitive LECs to provide service to new customers over a separate loop. In addition, it would enable residential consumers, for the first time, to benefit from head-to-head DSL competition on a level playing field.

In short, surrogate line sharing, as proposed by NorthPoint and HarvardNet, does not involve the exercise of the Commission's authority under section 251 to require access to a new unbundled network element. Rather, the approach would involve the exercise of the Commission's authority to "prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act."[12] In this case, the record in this proceeding fully supports a finding that interim remedial relief of is needed to address the current absence of competition in the residential DSL marketplace until the current dominant provider, the incumbent LEC, is able to offer line sharing to DSL competitive LECs. As noted above, the Commission is entitled to "substantial deference by courts" when it fashions a temporary remedy.

In addition to their jurisdictional claims, U S West and SBC also contend that the specific pricing principles advocated by the DSL competitive LECs are unreasonable. For example, NorthPoint and Harvard.Net suggested in their October 8 *Ex Parte* that the Commission could reasonably use the allocation used by the incumbent LECs in setting prices for their DSL offerings over shared lines as a reliable benchmark for determining the loop cost that should be allocated to line sharing.[13] U S West appears to argue that the use of an incumbent LEC's allocation of loop costs for its special access service is unreasonable because: 1) an incumbent LEC will incur other costs to provide line sharing to DSL competitive LECs that are not incurred when an incumbent offers line sharing as

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12 47 U.S.C. § 201(b).

13 *See* October 8 *Ex Parte* at 4.

a retail service; and 2) tying the allocation of loop costs for an unbundled network element to an incumbent's allocation of loop costs for its interstate special access line sharing service amounts to an imputation requirement.[14]

NorthPoint and HarvardNet addressed in their October 8 *Ex Parte* the issue of the incremental costs that an incumbent LEC may incur to provide line sharing to DSL competitive LECs. Although NorthPoint and HarvardNet recognized that an incumbent LEC may incur such costs, the evidence to date in the record indicates that those costs are likely to be quite small (e.g. access to a splitter) and certainly not of the magnitude alleged by the incumbent LECs. The point of using the incumbent LEC's allocation of loop costs was to provide an efficient and reliable measure for state commissions to use to determine the loop portion of the line sharing price in resolving arbitrations before them.

Moreover, NorthPoint and HarvardNet did not base their use of the incumbent LEC's allocation method on an imputation theory. Rather, they pointed out that the Commission's current pricing rules for special access require incumbent LECs to set the recurring prices for new interstate special access services at a level that is no less than the "direct costs" of providing that service, which are comparable to incremental costs.[15] NorthPoint and HarvardNet further observed that in light of the potential or actual availability of high speed Internet access service from other providers, such as cable television operators, it is reasonable to assume that market forces would tend to put pressure on the incumbent LECs to move the prices for their DSL offerings toward long run incremental costs. Hence, in these circumstances, it is entirely reasonable for the Commission to use the incumbent LECs' allocation of loop costs to its DSL special access service provided over a shared line as the benchmark for allocating loop costs to a shared line unbundled network element.

Incumbent LECs may also contend that the NorthPoint/HarvardNet "surrogate line sharing" proposal is inherently confiscatory because it requires an incumbent LEC to make access to an unbundled loop available at a significant discount from the price established for that element. The test for confiscation, however, is not whether a carrier earns a reasonable return on every service or facility that it offers. Rather, the test is whether the "total effect" of a particular ratemaking scheme can be said to be confiscatory.[16] As this Commission previously noted in assessing incumbent LEC confiscation arguments, "incumbent LECs' overall rates must be considered, including revenues for other services under our jurisdiction."[17] Applying this standard, it is clear

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14 *See* U S West Letter at 3.

15 *See Access Charge Reform*, Fifth Report and Order and Further Notice of Proposed Rulemaking (FCC 99-206), CC Dkt. No. 96-262 at para. 35 (Aug. 27, 1999); 47 C.F.R. 361.49(f)(2).

16 *See FPC v. Hope Natural Gas*, 320 U.S. 591, 602 (1944).

17 Local Competition First Report and Order, 11 FCC Rcd 15499, at para. 737 (1996).

that the NorthPoint/Harvard Net interim "surrogate line sharing" proposal is not confiscatory.

More fundamentally, requiring incumbent LECs to offer surrogate line sharing on an interim basis at a discounted rate does not involve "ratemaking" in the sense in which that term is typically used by regulatory bodies. Rather, it is tool to promote the development of competition in a market where the incumbent monopolist continues to possess significant advantages that hamper competitive entry. Indeed, the Commission in the past has used discounts from existing rates to offset competitive advantages of dominant carriers. When the FCC adopted its system of interstate access charges, for example, it ordered incumbent LECs temporarily to provide switched access services to MCI and other non-dominant carriers at a 55 percent discount from the rates paid by AT&T. The Commission reasoned that the substantial discount was needed to offset the superior access service that was only available to AT&T. [18] Similarly, in the case of line sharing, making access to an unbundled loop available to DSL competitive LECs (and the incumbent LEC) at a substantial discount is necessary to offset the marketplace advantage that an incumbent otherwise would have. Further, this interim remedy would strengthen an incumbent LEC's incentive to offer line sharing as an unbundled netowrk element expeditiously.

We have shown above that the objections to the pricing principles and interim line sharing arrangements advocated by DSL competitive LECs are without merit. Rather, the proposed measures represent a reasonable exercise of the Commission's broad authority under the Act in the interest of accelerating the development of residential competition for DSL service. In this case, the interim line sharing and surrogate line sharing proposals present an opportunity for the Commission to demonstrate to residential consumers that the pro-competitive provisions of the Act can deliver concrete benefits to them.

Respectfully submitted,

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[18] *See MTS WATS Market Structure*, Memorandum Opinion and Order, 97 F.C.C. 2d 834, 862 (1984).